

**MINUTES OF THE REGULAR MEETING OF THE  
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON  
Friday, February 16, 2001  
8:30 a.m., M.S.T.**

The Arizona State Retirement System (ASRS) Board met in the 10<sup>th</sup> Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85067-3910. Dr. Chuck Essigs, Chairman, Arizona State Retirement System Board called the meeting to order at 8:30 a.m., M.S.T.

The meeting was teleconferenced to the ASRS Tucson office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710-3776.

**1. Call to Order; Roll Call**

Present: Dr. Chuck Essigs, Chairman  
Mr. Jim Bruner, Vice Chairman  
Dr. Merlin DuVal  
Ms. Bonnie Gonzalez (via teleconference)  
Mr. Jim Jenkins  
Mr. Alan Maguire  
Mr. Norman Miller  
Mr. Karl Polen  
Mr. Ray Rottas

A quorum was present for the purpose of conducting business.

**2. Approval of Minutes of the January 19, 2001, Regular Meeting of ASRS Board and the Minutes of the January 19, 2001 Executive Session**

**Motion:** Mr. Jim Bruner moved to approve the minutes of the January 19, 2001, regular meeting of ASRS Board and the minutes of the January 19, 2001 executive session.

Dr. Merlin DuVal seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

**3. Board Approval of Consent Schedule**

**Motion:** Dr. Merlin DuVal moved that the ASRS Board approve the summary report of Retirements, Refunds and Death Benefits; System Transfers; and Applications and Agreements between the ASRS and the following Employer:

- Fort Mojave Mesa Fire Department

Mr. Ray Rottas seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

#### **4. Presentation, Discussion and Appropriate Action Regarding the Board Approval of the Renewal of the Mellon Trust Contract for Custodial Bank Services**

Mr. LeRoy Gilbertson, Director, stated that the third of four renewal periods under the custodial bank contract with Mellon Trust expires April 24, 2001. The ASRS staff has monitored the company's performance and has concluded that Mellon Trust has executed its contractual responsibilities. Staff recommends renewing the contract for another one-year term.

**Motion:** Mr. Jim Bruner moved to approve the extension for the fourth year of a potential five-year contract of Mellon Bank N.A., to provide custodial and ancillary services for the ASRS at the fee schedule as outlined below:

##### **I. CUSTODIAL AND ANCILLARY SERVICES**

Domestic/International Custody Services:	\$25,000/per month (includes portfolio mgmt. support)
Performance Analytics and On-line Services:	\$5,000/per month
STIF Management and Sweep Fee:	8 basis points
Securities Lending Revenue Split:	75% ASRS 25% Mellon Bank, N.A.
Benefit Payment Disbursement Services:	\$0.70 per check or ACH plus postage \$6.00 per lump sum payment plus postage \$0.13 per pensioner per month for Telephone Service Center

##### **II. ANNUAL RENEWAL**

1 <sup>st</sup> Renewal (4/1/98-3/1/99)	3% Increase
2 <sup>nd</sup> Renewal (4/1/99-3/31/00)	6% Increase
3 <sup>rd</sup> Renewal (4/1/00-3/31/01)	9% Increase
4 <sup>th</sup> Renewal (4/1/01-3/31/02)	12% Increase

The above fee for Custody Services assumes no significant increases to active international custody holdings and security purchase/sale transactions. Significant shall be defined as active international holdings exceeding \$250,000,000 and transactions exceeding 650 per annum. Should these events occur, Mellon reserves the right to review the appropriate fee

arrangement for International Custody Services. ADR holdings and transactions are not applicable.

Mr. Jim Jenkins seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

**5. Presentation, Discussion and Appropriate Action Regarding the Review and Recommendation for Benefit/Premium Changes for the PacifiCare Senior Supplement Plan**

Dr. Merlin K. DuVal reported that most of the transitional problems from other health insurance vendors to PacifiCare have been resolved. One residual problem is that the formulary in the current PacifiCare contract covers only mostly generic medication. PacifiCare has proposed to open the formulary, which will provide more access to medications, without authorization, for an additional \$13.02 per month per member. The co-pay and ceiling will remain the same. The LTD/Health Insurance Board Committee reviewed this proposal and decided the majority of the beneficiaries would be advantaged by accepting the amendment to the contract. Ms. Donna Buelow, Assistant Director, Member Services, contacted the presidents of many of the retiree organizations in the state and reported that, with a few exceptions, the recommendation was to adopt the proposal.

**Motion:** Dr. Merlin DuVal moved to accept the amendment to the contract with PacifiCare as recommended by the LTD/Health Insurance Board Committee.

Mr. Jim Bruner seconded the motion.

Mr. Jim Jenkins requested that the Board hear from any concerned members of the public regarding this issue.

Dr. Essigs invited Ms. Buelow to share any comments she received from the organizations. Ms. Buelow stated that when she spoke to the organizational leaders, they expressed belief that while it is not a perfect solution because of the cost involved, there would be a high degree of acceptance for the proposal because it would provide some benefit.

Mr. Norman Miller asked if the cost would be to the state or to the member. Dr. Essigs responded that members would pay the additional \$13.02 per month.

Mr. Gale Richards of the Arizona State University Retirees' Association asked whether the increased premium would be mandatory for all members. Dr. DuVal responded that the change would apply to all members enrolled in the PacifiCare Senior Supplement Program.

Dr. DuVal cautioned members not to use brand drugs if they are not necessary because all prescriptions will count against the \$1,800 ceiling per year and anything over that amount

will have to be paid in full by the members. He requested the ASRS include an alert in an upcoming ASRS newsletter regarding the \$1,800 ceiling.

Ms. Kathleen Oates of Phoenix expressed concern that the increase was substantial and asked whether there was any way to negotiate a lower price. Dr. Essigs replied that there were only a couple of bids to provide health insurance and this is the best option offered at this time.

Mr. Robert Whalen of Tucson noted that he has been unable to obtain a few prescriptions and he also hears rumors that doctors are dropping PacifiCare patients.

Mr. Bill Peltier of the Pima County Teachers' Association reported that his group recommends approval of the proposal to open the formulary at an additional cost.

Mr. Jim Jenkins asked if all the enrollment cards have been sent out. Ms. Buelow responded that although there were significant issues with cards and coverage, all of the cards have been sent out and the turnaround time for the few problems that now crop up has improved. The ASRS continues to monitor the situation to make sure members get all of the information they need.

Mr. Dan Cadriel, Business Manager, PacifiCare pointed out that there have been several mailings to inform members of their enrollment options and that all cards have been sent to everyone who has responded. He also commented that members should remember to manage the \$1,800 cap and work with their doctors so that their prescriptions are covered over a longer period of time. He also stressed that Medicare provides primary coverage on some drugs and that PacifiCare is not required to cover some drugs. He also pointed out that if doctors accept Medicare, under the Senior Supplement Plan there should be no problem coordinating the billing with PacifiCare.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

Dr. Essigs commended Dr. DuVal and the ASRS for working to address some of the issues members raised.

Dr. DuVal also noted that a bill introduced in the Legislature would require that the state only accept a health insurance contract that covers every county in the state in order to alleviate concerns that rural areas are not receiving adequate coverage. He reminded members that no insurance company will accept that as a condition for business.

## **6. Presentation, Discussion and Appropriate Action Regarding the Fiscal Year 2000 Audit Findings and Annual Report**

Mr. Karl Polen, Chairman, Audit Board Committee, reported that the committee had received and reviewed the Fiscal Year 2000 Audit Report and found everything to be in order.

**Motion:** Mr. Karl Polen moved to accept and adopt the recommendations from the Board Audit Committee to accept the Fiscal Year 2000 Independent Auditor's report.

Mr. Jim Jenkins seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

## 7. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance for the Period Ending December 31, 2000

Mr. Terry Dennison, Principal, Mercer Investment Consulting, Inc., presented an economic and market review and reported on the Total Fund Performance for the period ending December 31, 2000.

### Total Fund Performance for Period Ending December 31, 2000

	<b>Qtr</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
<b>Total ASRS Fund</b>	-3.2%	-2.0%	12.0%	13.8%	13.9%
<b>Benchmark*</b>	-3.4	-4.0	9.8	12.1	12.7
<b>TUCS Public Fund Median</b>	-2.8	0.2	9.6	12.3	12.6

\*1/1/89-12/31/91 is 60% S&P 500/40% LB Aggregate,  
 1/1/92-12/31/94 is 50% S&P 500/40% LB Aggregate/10% EAFE,  
 1/1/95-6/30/97 is 45% S&P 500/40% LB Aggregate/15% EAFE,  
 7/1/97-12/31/99 is 50% S&P 500/35% LB Aggregate/15% EAFE, and  
 1/1/00-Present is 53% S&P 500/30% LB Aggregate/17% EAFE

### Performance vs. Benchmarks for the 3 Years Ending December 31, 2000

	<b>Return</b>	<b>Assumed ROR</b>	<b>Std. Dev.</b>	<b>Assumed Std. Dev.</b>
<b>Total ASRS Fund</b>	12.0%	8.4%	13.2%	11.8%
<b>Benchmark</b>	9.8%		11.9%	
<b>Domestic Fixed LB Aggregate</b>	6.3 6.4	5.6	3.6 3.5	5.3
<b>Domestic Equity S&amp;P 500</b>	12.7 12.3	9.4	19.9 19.4	16.3
<b>International Equity EAFE</b>	16.0 9.6	10.0	21.7 20.06	21.5

## Performance vs. Benchmarks for the 5 Years Ending December 31, 2000

	<b>Return</b>	<b>Assumed ROR</b>	<b>Std. Dev.</b>	<b>Assumed Std. Dev.</b>
<b>Total ASRS Fund Benchmark</b>	13.8% 12.1%	8.4%	11.0% 10.0%	11.8%
<b>Domestic Fixed LB Aggregate</b>	6.4 6.5	5.6	4.1 3.6	5.3
<b>Domestic Equity S&amp;P 500</b>	18.1 18.3	9.4	16.5 16.2	16.3
<b>International Equity EAFE</b>	11.0 7.4	10.0	18.5 17.2	21.5

Mr. Alan Maguire was excused at 9:38 a.m.

**8. Presentation, Discussion and Appropriate Action Regarding the Performance of Domestic Small Cap Equity Managers for the Period Ending December 31, 2000**

Mr. Terry Dennison, Principal, Mercer Investment Consulting Inc., reported on the following Investment Manager's performance for the Arizona State Retirement System: Axe-Houghton, Brandywine Investments, Dimensional Fund Advisors, and Mellon Capital Management for the period ending December 31, 2000.

Mr. Seth Lynn, President, reported on Axe-Houghton and Associates' performance for the period ending December 31, 2000.

	<b>Quarter (12/31/00)</b>	<b>6 Months</b>	<b>1 Year</b>	<b>Since Inception (August 31, 1998)</b>
Style (Value Advantage)	15.0	21.9	26.0	(2.8)
Sector Selection	0.0	0.0	0.0	0.0
Stock Selection	(3.1)	0.7	(3.3)	3.2
Others				
Fees	(0.0)	(0.1)	(0.1)	(0.1)
Total	11.9	22.5	22.6	0.3

Mr. Adam Specter, Director of Client Services, and Mr. Henry Otto, Portfolio Manager, reported on Brandywine Investment Partners' performance for the period ending December 31, 2000.

<b>Rate of Return</b>	<b>Quarter (12/31/00)</b>	<b>1 Year</b>	<b>Since Inception (August 31, 1998)</b>
Sector Selection	9.4	8.2	-4.7
Stock Selection	5.8	4.3	-3.9
Others	N/A	N/A	N/A
Fees (%)	-0.1	-0.4	-0.9
Total Value Added Relative to Benchmark	15.1	12.1	-9.5

Mr. George Sands, Vice President, and Mr. Henry F. Gray, Vice President & Portfolio Manager, reported on Dimensional Fund Advisors' performance for the period ending December 31, 2000.

<b>Total Rate of Return</b>	<b>Quarter (12/31/00)</b>	<b>1 Year</b>	<b>Since Inception (August 31, 1998)</b>
Sector Selection	-0.97	3.29	3.41
Stock Selection	15.58	13.92	-1.68
Others***	0.44	2.08	-0.96
Fees (%)	-0.06	-0.23	-0.23
Total Value Added Relative to Benchmark	14.99	18.73	0.28

\*\*\*Others - Turnover, trading experience and cash flow

Mr. Jeff Elms, Vice President, Client Services, and Ms. Susan Ellison, Managing Director, Equity Portfolio Management reported on Mellon Capital Management's performance for the period ending December 31, 2000.

	<b>Quarter (12/31/00)</b>	<b>1 Year</b>	<b>Annualized Since Inception (August 31, 1998)</b>
Stock Selection	0.39%	0.33%	0.76%
Securities Lending	0.03	0.11	0.10
Cash Drag/Other	0.05	0.05	-0.05
Fees	-0.01	-0.03	-0.03
Value Added	0.46%	0.46%	0.78%

## **9. Presentation, Discussion and Appropriate Action Regarding Current Legislative Issues**

Mr. Norman Miller commended the ASRS staff for the attention it is giving to the issues at the Legislature and the reporting of information to the Board, such as providing cost estimates and priorities in weekly meetings and dialogues with the External Relations and Legislative Board Committee.

Dr. Essigs encouraged Board members to participate in these informative Friday meetings via teleconference.

Mr. Tom Augherton, Deputy Director External Operations, gave a brief overview of the trends in this legislative session. There are only three more weeks before the deadline for all bills to be heard in the chamber of origin. There are 37 bills introduced regarding retirement issues; 17 bills deal with the ASRS, although some are duplicates in entirety or portion. The information about the fiscal impact of some of these bills is still not being made available to the House Retirement and Government Operations Committee members because the chair of the committee moves the bills quickly, with very little testimony. Mr. Miller noted that this is significant because many of the ASRS-related bills have a greater fiscal impact than many money bills.

Mr. Augherton noted that the Senate is moving slower and there has not been as much action on the retirement bills. There has also been more concerted effort from the ASRS to communicate with retiree groups to inform them about the issues that may affect them, without advocating a particular position, via meetings, briefings and weekly mailings.

Mr. Augherton reported on the status of the following bills:

### **SB 1295 (retirement benefits; defined contribution supplement)**

By Senator Cirillo

Has been held up in the Senate Finance Committee. Members of the Committee signed a discharge petition and it will be heard in committee.

### **HB 2004 (ASRS; actuarial computation method)**

By Representatives Brimhall, Gray and Senator Cirillo

Has not yet been heard by the House Appropriations Committee. The ASRS has formally requested that the chair of the committee hear the bill.

### **HB 2170 (emergency telephone service; children)**

By Representative Brimhall

Basically a striker bill and vehicle to include language from five other bills that have not moved yet through the Appropriations Committee.

Amended and passed in the House Retirement and Government Operations Committee to provide the following:

- EAN Valuation Method. Identical to HB 2004.



- Health Insurance Premium Benefit - increases the premium benefit for members of the eligible state retirement systems.
- Until December 31, 2004, provides an additional benefit for retired and disabled members who live in areas of the state not served by an HMO and who have ten years of credited service. Identical to HB 2164.
- Graded Multiplier - provides a graded multiplier. Identical to HB 2048 and SB 1512.
- Lump Sum Retirement Benefit – allows a member the option of taking a lump sum payment equal to up to 36 months of the member's benefit. The member's benefit would be actuarially reduced so the option is cost neutral. Identical to one of the provisions in SB 1295.
- Retirees benefit increase – provides an increase in retirement benefits for members retired prior to the effective date of the graded multiplier.

**HB 2169 (supplemental defined contribution plans)**

By Representative Brimhall

Passed the House by a vote of 57-1. It should be heard in the Senate Finance Committee soon.

**SB 1117 (ASRS; omnibus)**

By Senator Cirillo

Passed the Senate by a vote of 30-0.

**SB 1107 (retirees; health insurance; subsidies)**

By Senators Arzberger, Guenther, Rios, Mitchell, Solomon, Verkamp, Bee plus 5;

Representatives Lugo, Soltero, Lored, Maiorana, Miranda plus 6

Passed the Senate Finance Committee. Mr. Augheron believes this bill is most likely to pass out of all the bills introduced to address the retirees' health insurance premium.

**HB 2079 (retired teachers; return to work)**

By Representatives Huffman, Hershberger, Binder, Allen plus 3

The director testified before the House Education Committee as to the significant actuarial impact this bill will have. It has been referred to the House Retirement and Government Operations Committee.

Ms. Bonnie Gonzalez thanked Mr. Augheron and the ASRS staff for providing weekly updates, which she has found beneficial when talking with constituents.

**Mr. Ray Rottas was excused at 11:12 a.m.**

**10. Director's Report**

Mr. Gilbertson presented a Certificate of Achievement for Excellence in Financial Reporting in 1999, sponsored by the Government Finance Officers' Association, to Ms. Jan Holt, Comptroller.

Mr. Jim Jenkins congratulated the accounting staff for achieving this highest form of recognition in public employee retirement system accounting and financial reporting.

Mr. Karl Polen asked the reason for the increased length of time to do a service purchase over the past couple of months, as noted in the Operations report.

Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, responded that the program has been re-engineered to increase the number of service purchases without additional resources. This created a bit of a backlog, but with the new system in place, staff hopes it will be reduced within a few months. Mr. Gilbertson also noted that the number of calls to the Member Service Center also increased and it is that same staff that does service purchases.

Mr. Norman Miller noted on the report on the operation of the 3300 Tower that the settlement with Wells Fargo is not reflected in the income. He suggests it be amortized over the life of what would have been their remaining lease. Mr. Paul Matson noted the point.

Mr. Norman Miller asked if the active venture capital equity fund with Valley Ventures is really \$25,000. Mr. Matson responded that it is correct and it will probably not be included in future reports. Mr. Miller requested a historical overview of the ASRS' experience with Valley Ventures be prepared for possible future discussion.

## **11. Board Requests for Agenda Items**

There were no Board requests for agenda items.

## **12. Call to the Public**

There were no requests to speak from the Tucson public.

Mr. Joe Hunter, retired teacher, expressed concern about PacifiCare and the ability to get prescriptions.

Mr. Ben Lindsey shared his experience as a retired teacher who was offered an early-retirement incentive. He and other teachers have received confusing information from the ASRS and the Attorney General's Office as to what would be considered compensation and be used to calculate benefits. Mr. Fred Stork, Assistant Attorney General, stated that he is studying the situation and the impact of past opinions and practices and will distribute his explanation and recommendation to the Board shortly.

Mr. Jim Barlow also addressed the Board regarding retired teachers' compensation and benefit calculations. Dr. Essigs said the issue would be addressed at a future Board meeting.

**13. The next regular ASRS Board meeting is scheduled for Friday, March 16, 2001, at 8:30 a.m. in the Tucson Office, 7660 East Broadway Blvd., Suite 108, Tucson, AZ 85710-3776.**

**14. Adjournment of the ASRS Board**

Dr. Chuck Essigs, Chairman, adjourned the February 16, 2001, regular meeting of the ASRS Board at 11:37 a.m.

Respectfully submitted,

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Maurah Harrison, Secretary

Date

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LeRoy Gilbertson, Director

Date